Agenda Date: 10/25/01
Agenda Item: 2 C

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE PETITION OF NEW JERSEY NATURAL GAS COMPANY FOR AUTHORITY TO ENTER INTO A CAPITAL LEASE FINANCING OBLIGATION	))))	ORDER AUTHORIZING EXECUTION OF CAPITAL LEASE OBLIGATION DOCKET NO. GF01030184

Jacqueline Hardy, Esq., Attorney for New Jersey Natural Gas Company.

Fred S. Grygiel, Chief Economist, Mark C. Beyer, Manager, Office of the Economist on behalf of the Staff of the Board of Public Utilities.

BY THE BOARD:

On March 21, 2001, New Jersey Natural Gas Company (Petitioner or NJNG), a public utility of the State of New Jersey, filed a petition with the New Jersey Board of Public Utilities (Board), pursuant to N.J.S.A. 48:3-7 and 48:3-9, requesting authority to enter into a capital lease financing obligation (Lease) with Fleet Capital Corporation (Bank), which obligation will result in a lower overall financing cost to Petitioner for the acquisition of meters and related equipment, including capitalized labor costs, that Petitioner currently owns and will acquire on an annual basis (Property).

BACKGROUND

Petitioner requests authority to enter into a master lease agreement with the Bank to refinance, at a lower interest rate on an annual basis, Petitioner's long-term debt cost associated with its purchase of the Property and thereby reduce its comparable pre-tax long-term debt interest rate from approximately 6.83% to 6.18% based on the ten (10) year Treasury rate. Specifically, Petitioner proposes to transfer to the Bank, for tax purposes, title to the Property on annual basis and lease back the Property at the proposed reduced interest rate. The Lease term will be for a period of eleven (11) years or 132 months. Petitioner will transfer the Property to the Bank at net book cost. The Lease contains an early buy-out option, which gives NJNG the right to reacquire title to the meters in the 117th month before the end of the Lease term at approximately 20.2584% of the Lease price. Petitioner shall be responsible for insurance, taxes, if any, and maintenance expenses. All individual Lease transactions shall be subject to the same terms and conditions of the Lease. Both the proposed interest rate and the Lease term are fixed.

Under the initial Lease transaction, Petitioner proposes to transfer to the Bank title to the Property Petitioner bought during the fiscal years October 1, 1997 through September 30, 2000 and lease back such Property at the proposed reduced interest rate. Petitioner will transfer the Property at a net book cost of approximately $16,635,020.00, thereby reducing Petitioner's current monthly debt payments from approximately $175,081.62 to $168,362.79. As a result of this initial Lease transaction, Petitioner projects total gross pre-tax savings of $786,103.26. The net after-tax benefit, present-valued using Petitioner's after-tax weighted average cost of capital of 7.56%, is $841,164.99. The after-tax savings net of the taxes paid on the gain from the sale of the Property are $208,324.25. Such savings ultimately will be passed on to Petitioner's customers in the form of reduced capital costs. Petitioner also plans to transfer an additional $5 million in such Property during the 2001 fiscal year ending September 30, 2001 and additional such Property to the Bank on an annual basis. These transactions will not be subject to tax gains.

Petitioner must transfer title to the Property to the Bank under the federal income tax rules to achieve the benefit of the projected financing savings. There are no up-front fees associated with the Lease and closing costs are minimal.

The transfer of title to the Property is solely for the purpose of achieving the tax benefits of the Lease transaction. The Bank will not accrue any beneficial rights of ownership to the Property other than the right to lease the Property back to NJNG during the term of the Lease. Therefore, NJNG retains its rights and responsibilities to specify meter requirements, purchase meters consistent with these requirements, perform meter installations, operate and maintain meters, and remove meters, all in a manner performed under its sole discretion. NJNG will retain responsibility for complying with all federal and state regulations concerning the Property covered under the limited title transfer, including all regulations pertaining to safety. The Board and any other authority with oversight of NJNG's metering functions will retain the same ability to carry out its regulatory obligations with respect to the Property as existed prior to closing of the proposed transaction.

On September 20, 2001, the Division of the Ratepayer Advocate ("RPA") filed a letter with the Board objecting to approval of the transaction, as proposed. The RPA stated that the transaction appears to raise several policy issues, in that assets directly used in the provision of services are leased, and these assets are located on customer premises. The RPA also questioned whether the transaction might unreasonably impede a transition to a competitive customer account services market. The letter states:

> In sum, the Ratepayer Advocate does not support approval of the transaction, as proposed. If the Board nonetheless elects to approve the proposed transaction, the Ratepayer Advocate respectfully submits that any approval be conditioned on certain safeguards to protect ratepayers and promote competition. First, any approval should not be "open ended." Until the issue of Capital Lease financing of utility assets directly involved in the provision of utility service is more fully examined, with opportunity for comment by competitive suppliers and others, the proposed transaction should be limited to a specifically delineated group of assets. Second, conditions should be placed on the transactions to ensure that ratepayers are not harmed if, in the future, customers migrate from utility-owned meters to those supplied by competitive suppliers. Finally, in any future rate proceeding, for each transaction NJ Natural Gas

should be required to perform an analysis of the cost of financing through a Capital Lease transaction vis-à-vis other forms of debt financing.

NJNG responded to the RPA on September 21, 2001, stating that it did not object to performing a comparative cost analysis of capital lease financing in any future rate proceeding. With respect to the objection to an “open-ended” approval, NJNG agreed to lease no more than 15,000 meters a year from Fleet (about $6,000,000 worth) out of a total of 400,000 meters. The initial transaction involves approximately 80,000 meters.

DISCUSSION

Initially, the Board notes that NJNG has clarified that the transaction is not open-ended, but rather is limited to the financing and acquisition of a limited number of gas meters. If, at some future date, metering becomes a competitive service, the Lease allows the meters to be moved to other locations, since control of the operation and placement of the meters is no different than if the meters were financed by debt and/or equity. As the petition and the Petitioner’s responses to the staff and RPA discovery requests indicate, the capital lease transaction will have no effect on operations, but appears to be a cost effective method to raise a relatively small amount of money on a flexible basis.

The Board, after investigation and having carefully considered the petition and exhibits submitted in this proceeding, FINDS that the proposed transaction is in accordance with the law, is in the public interest and HEREBY AUTHORIZES Petitioner to execute the capital lease financing obligation (Lease) with Fleet Capital Corporation, which obligation will result in a lower overall financing cost to Petitioner for the acquisition of meters and related equipment, including capitalized labor costs, which Petitioner currently owns and will acquire on an annual basis.

This Order is issued subject to the following conditions:

1. Petitioner shall furnish the Board, as promptly as is practicable following the execution of the Lease, a signed copy of the Lease and all other material documents executed between Petitioner and Fleet Capital Corporation.

2. Petitioner shall furnish the Board, as promptly as is practicable following each subsequent Lease transaction, a report of such transaction, including the journal entry. Subsequent lease transactions shall be limited to the sale/leaseback of no more than 15,000 meters annually.

3. Petitioner shall also furnish as promptly as is practicable a certified copy of the resolution of Petitioner’s Board of Directors authorizing the Lease.

4. This Order shall not affect nor in any way limit the exercise of the authority of this Board or of the State of New Jersey in any future proceeding with respect to rates, franchises, services, financing (including method of sale of securities), accounting, capitalization, depreciation or any other matters affecting Petitioner.

5. This Order shall not affect nor in any way limit the exercise of the authority of this Board or of the State of New Jersey with respect to Petitioner's metering functions.

DATED: October 26, 2001

BOARD OF PUBLIC UTILITIES
BY:

[SIGNED]
CONNIE O. HUGHES
PRESIDENT

[SIGNED]
FREDERICK F. BUTLER
COMMISSIONER

[SIGNED]
CAROL J. MURPHY
COMMISSIONER

ATTEST:

[SIGNED]
FRANCES L. SMITH
BOARD SECRETARY